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Restaurant Business
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MARCH 20, 1989

FRANCHISE HERO

DeLuca Rides Subway To The Top 126

MAJOR FORCES IN FRANCHISING 85

INDEPENDENT: JUNIOR'S 'BLINTZES' BROOKLYN 80

MENU IDEAS: RICE & BEANS 181

WIN A TRIP FOR TWO

SWEEPSTAKES!

FOR DETAILS SEE PAGE 22

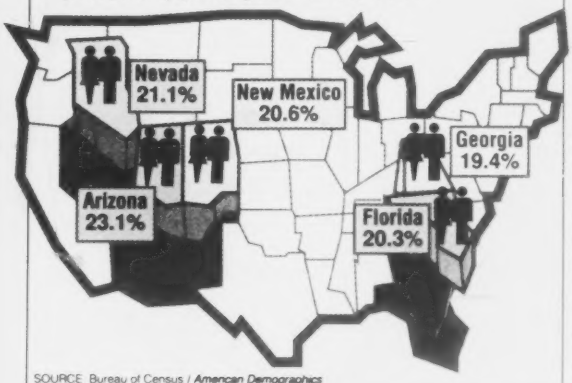
BUSINESS BAROMETER

The Hard Facts Shaping Our Industry

By Howard Riell

STATES' GROWTH

Projected percent population growth from 1990 to 2000



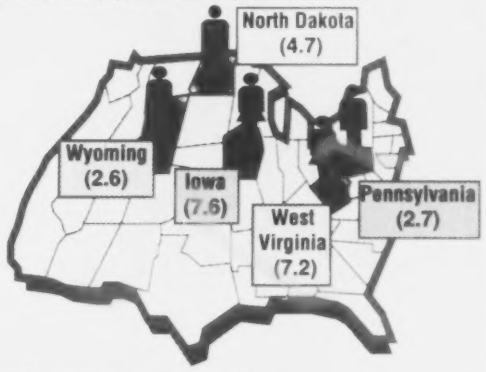
SOURCE: Bureau of Census / *American Demographics*

Which States Will Grow The Fastest...

According to the Census Bureau's just-released figures, the population of the United States will increase by five million between now and the end of the century. California will remain the most populous state, with more than 37 million residents. New York, which is now the second largest, and Texas, now third, will trade positions. Between 2000 and 2010, however, no state's population is expected to grow by more than 20%. Hawaii's growth during that period is expected to overtake that of next decade's leader Arizona during that decade by a 1% margin—16% to 15%.

STATES' SHRINKAGE

Projected percent population decrease from 1990 to 2000



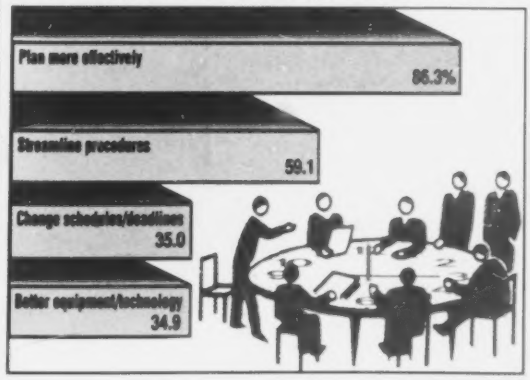
SOURCE: Bureau of Census / *American Demographics*

...And Which Will Shrink The Fastest?

The Census Bureau projects that Iowa will lose 21,000 people per year between 1990 and 2000. The state is also expected to maintain the nation's highest rate of decrease into the decade that follows—approximately 7% by 2010 (a cartoon in the *Des Moines Register* asked, "Will the last one to leave please turn off the lights?"). Wyoming will remain the country's least populous state through 2010, although it is not among the 10 states showing the fastest decrease. Pennsylvania is expected to lose an average of 35,000 residents per year between 1990 and 2010.

CONTROLLING OVERTIME

Percent of managers who feel these techniques are effective, 1989



How Do You Control Overtime Costs?

According to a recent survey of 322 managers conducted by the Houston-based American Productivity & Quality Center, "At least some of the overtime reported by respondents is, indeed, covering poor management." The managers polled overwhelmingly chose more effective planning as their preferred strategy for controlling the worsening overtime cost problem. Just under 26% said the solution was to hire more permanent staff. With foodservice labor costs skyrocketing, operators are well advised to consider any or all of these options.

RESTAURANT BUSINESS

CONTENTS

MARCH 20, 1989 VOL. 88 NO. 5

COVER STORY: *Subway's Franchising Success, page 126.*

MENU IDEAS: *Rice & Beans, page 181.*

CHEF'S ART: *Lucky's, page 189.*

COVER STORY

REPORT **FRANCHISING.** *The 24th annual franchising report analyzes the forces shaping a dynamic marketplace. Segment reports cover the 11 major markets, and a special profile of Subway reveals the secrets behind the fastest-growing franchise system. In addition, RB discusses franchising co-ops and takes a look at franchisee/franchisor conflicts. The report also includes an exclusive analysis of the franchising economy, as well as a ranking of the Top 50* 85

HAMBURGER 86
SEAFOOD 92
CHICKEN 94
PANCAKE 100
PIZZA 102
MEXICAN 108
STEAK 114
SANDWICH 116
ICE CREAM 120
DONUT 122
C-STORE 124
SUBWAY'S ON TOP 126
FRANCHISING IN FOODSERVICE 132
CO-OPS 133
SYSTEM TURMOIL 140

FOOD AND BEVERAGE

DRAFTS, CARAFES & SPIRITS **DOMESTIC BEER.** *Operators should not underestimate the importance of merchandising domestic brews.* 175

MENU IDEAS **RICE & BEANS.** *Glamorous grains and legumes are moving front and center of the plate* 181

CHEF'S ART **LUCKY'S.** *In Providence, RI, Johanne Killeen and George Germon serve Cool Vermicelli Salad* 189

FEATURES

INDEPENDENT **JUNIOR'S.** *Despite changing demographics in its Brooklyn, NY, neighborhood, this kosher-style restaurant has managed to thrive* 80

POLICY **DWI UPDATE.** *Despite restrictive legislation and demands for increases in excise taxes, the picture looks brighter in terms of insurance and third party liability, due in part to improved training* 152

Cover photograph of Fred DeLuca by Don Kushnick.

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COLUMNS AND DEPARTMENTS

BUSINESS BAROMETER 2
LETTERS TO THE EDITOR 9
INSIGHTS. *Industry News* 16
TRADE QUOTES. *Stock Market Reports* 48
MENU PLANNER'S GUIDE 52
FOOD FACTS. *Alcohol* 66
MANAGEMENT. *Encouraging Fast-Trackers* 70
EQUIPMENT I.Q. *Combination Ovens* 74
COMPUTER LINK. *Time Management* 162
BUYER'S CIRCLE. *Noteworthy Equipment* 164
BAR MANAGEMENT GUIDE 178
WINE SELLER. *Wine Lists That Sell* 192
LATELINE. *Last-minute Newsbreaks* 209
WASHINGTON WATCH. *Capitol Observations* 210
SPECIAL REPORT 211
INDEX TO OPERATORS/ADVERTISERS 212
READER COMMENT CARD 213

RB INSIDER

TGI FRIDAY'S INC., *the Dallas-based operator of 124 TGI Friday's and 16 Dalts, is quickening unit expansion, rolling out a smaller prototype, and strengthening its marketing efforts* 16

UPCOMING CONFERENCE

Participants from all segments of the foodservice and meat industries will gather at the first **CENTER-OF-PLATE** *Foodservice Marketing Conference. The Conference, scheduled for April 3 to 5 at the Hyatt Regency in Chicago, is cosponsored by* Restaurant Business *and the American Meat Institute.* RB's *sister publications,* Institutional Distribution *and* Food-Service Director, *will also participate. For information, contact Editor Peter Berlinski,* Restaurant Business, *633 Third Avenue, New York, NY 10017.*

REPRINTS, INDEX AVAILABLE

Restaurant Business *now has available specially prepared reprints of the* **1988 RESTAURANT GROWTH INDEX** *and the* **1988 MAJOR FORCES IN FRANCHISING.** *The reprints are available for $5 per copy.*

In addition, Restaurant Business *is now offering its* **1988 EDITORIAL INDEX** *for $25 per copy.*

Direct inquiries to: Editor Peter Berlinski, Restaurant Business, *633 Third Avenue, New York, NY 10017.*

FRANCHISING: *The Hamburger Segment, page 86.*

IN THE NEXT ISSUE

COVER STORY

POLITICAL UPDATE

What does the new administration have in store for the restaurant industry over the next four years? Certainly, minimum wage and parental leave and health benefit issues will continue to be front-line concerns, but momentum is also beginning to build in the areas of waste disposal, food safety, and the General Accounting Office's so-called "sweatshop report." This article examines the issues, at both the national and statewide levels.

MARKET SEGMENT REPORT

ICE CREAM & YOGURT

Americans' love affair with frozen treats seems to be insatiable, if the recent growth in this category is any indication. Superpremium and "adult" flavors, frozen novelties, and "lite" alternatives, including frozen yogurt, are all important trends, while many chains are branching out with more savory menu items like sandwiches and salads.

MENU IDEAS

BREAKFAST & BRUNCH

The morning daypart continues to hold promise for operators. In the *RB* Test Kitchen, we developed a number of recipes for breakfast and brunch, from convenient hand-held fast-food items to elegant entrees.

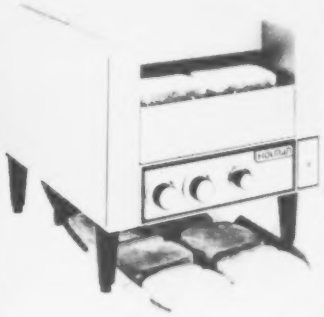
DRAFTS, CARAFES & SPIRITS

DESSERT WINES, LIQUEURS & BRANDIES

Smart marketers are realizing the add-on potential of after-dinner libations, which help build an upscale image and profits.

HOLMAN

CONVEYOR TOASTERS



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FRANCHISING IN FOODSERVICE

Over the past two decades, franchising has emerged as a powerful force behind the industry's sustained growth. And, as the foodservice industry enters the 1990s, there is every indication that franchising will continue to succeed, as would-be operators seek ways to reduce risk and increase their chances of prosperity. As the industry consolidates and matures, becoming increasingly more competitive as the market reaches saturation, franchising offers operators a "package deal," with all the systems and resources of a major company behind the concept.

Already, franchising accounts for $63 billion of the $137 billion eating-place market. The Top 50 franchise chains alone generate some $60 billion in annual sales (see page 144). In 1989, according to our estimates, sales by franchised restaurant chains are expected to top the $70 billion mark. And they will keep on growing, picking up momentum into the next decade as they move beyond the nation's boundaries to bring American foodservice concepts to countries around the world.

In the past, *Restaurant Busi-*

RESTAURANT FRANCHISING, 1987-1989
SALES ($000)

MAJOR ACTIVITY	1987 Total	1987 Company-Owned	1987 Franchisee-Owned	1988* Total	1988* Company-Owned	1988* Franchisee-Owned
Chicken	$4,821,580	$1,850,141	$2,971,439	$5,344,553	$2,046,256	$3,298,297
Hamburgers, Franks, Roast Beef, etc.	27,257,232	6,662,933	20,594,299	30,385,756	7,402,519	22,983,238
Pizza	8,126,293	3,171,192	4,955,101	9,086,583	3,551,735	5,534,848
Mexican	3,078,981	1,682,443	1,396,538	3,317,041	1,776,660	1,540,381
Seafood	1,479,704	875,194	604,510	1,666,020	988,969	677,051
Pancakes, Waffles	1,308,610	429,865	878,745	1,435,363	459,956	975,407
Steak, Full Menu	9,811,267	5,259,970	4,551,297	10,724,014	5,717,587	5,006,427
Sandwich and Other	956,327	95,162	861,165	1,185,565	116,859	1,068,706
TOTAL	$56,839,994	$20,026,900	$36,813,094	$63,144,895	$22,060,540	$41,084,355

* *Estimated by respondents*

RESTAURANT FRANCHISING, 1987-1989
NUMBER OF UNITS

MAJOR ACTIVITY	1987 Total	1987 Company-Owned	1987 Franchisee-Owned	1988* Total	1988* Company-Owned	1988* Franchisee-Owned
Chicken	9,391	3,218	6,173	9,688	3,298	6,389
Hamburgers, Franks, Roast Beef, etc.	33,031	7,047	25,984	34,647	7,364	27,283
Pizza	17,739	5,769	11,970	19,761	6,438	13,323
Mexican	4,733	2,110	2,623	5,090	2,205	2,885
Seafood	2,684	1,552	1,132	2,917	1,681	1,236
Pancakes, Waffles	1,921	625	1,296	2,056	650	1,406
Steak, Full Menu	10,044	4,789	5,255	10,716	5,067	5,649
Sandwich and Other	3,788	288	3,500	4,504	339	4,165
TOTAL	83,331	25,398	57,933	89,379	27,042	62,337

* *Estimated by respondents*

ness has prepared its annual franchising report with the cooperation of the U.S. Department of Commerce. Commerce's report, entitled "Restaurant Franchising in the Economy," ceased to be published in 1988, so this year, our proprietary statistical analysis of franchising in foodservice was prepared in conjunction with the consulting firm Technomic Inc., Chicago.

	1989*		
	Total	Company-Owned	Franchisee-Owned
	$5,911,992	$2,250,882	$3,661,110
	33,880,118	8,253,808	25,626,310
	10,224,478	3,942,426	6,282,052
	3,672,465	1,901,026	1,771,439
	1,841,066	1,075,999	765,068
	1,552,769	494,452	1,058,317
	11,953,861	6,146,406	5,807,455
	1,387,461	137,076	1,250,386
	$70,424,210	$24,202,074	$46,222,136

	1989*		
	Company-Total	Franchisee-Owned	Owned
	9,994	3,381	6,613
	36,206	7,696	28,511
	22,003	7,082	14,921
	5,547	2,315	3,232
	3,083	1,748	1,335
	2,167	676	1,491
	11,489	5,219	6,271
	5,044	380	4,665
	95,533	28,496	67,037

CO-OPS

In the world of restaurant franchising, advertising and purchasing co-ops operate according to a simple principle: The whole is greater than the sum of the parts.

The cost-effectiveness of pooling dollars is a persuasive argument for co-ops. The economies of scale fostered in a co-op system allow franchisees as a group to buy more media time or purchase products at better prices than they would be able to do individually.

"Our 40 stores in New York could never afford to use TV or radio as individuals," says director of marketing Paul Hall of North Hollywood, CA-based International House of Pancakes (IHOP). "They'd be fortunate to afford the local shopper's paper."

Co-ops also maintain a consistent, coordinated advertising voice in a widespread organization. "The customer does not understand the difference in management from unit to unit," points out vice president of franchising Bob Bafundo of Columbus, OH-based Rax.

SPIRIT OF EXCHANGE. Moreover, co-ops that have a true spirit of exchange can foster a synergy of ideas and creativity. For example, McDonald's Big Mac, Filet-O-Fish, and Egg McMuffin are all menu items developed from owner/operator ideas. Over the years, McDonald's has leveraged co-op power to build the world's most successful franchise organization. At its most basic, McDonald's is "a large cluster of small entrepreneurs," as John F. Love wrote in his 1986 book, *McDonald's: Behind The Arches.*

Love hit upon the basis of McDonald's success when he wrote the following about the chain and its late founder, Ray A. Kroc: "What eventually separated McDonald's from the rest of the pack was Kroc's ability to marshal the efforts of hundreds of other entrepreneurs—his McDonald's franchisees—to work not merely for their selfish interests but for McDonald's interests."

McDonald's organizes its franchisees into co-ops based around TV markets. They are required to spend a minimum of 4% of gross sales annually for advertising and promotion.

As the company franchising brochure states, a voluntary national cooperative of franchises called the OPNAD (Operator's National Advertising) Fund, together with the company, purchases national TV advertising. Although the parent company prepares TV spots, print ads, and POS materials for the restaurants, franchisees themselves meet in co-op groups to decide how best to use these materials in their markets.

The Oklahoma City, OK-based Sonic drive-in chain has made great strides in its co-op program since starting it from scratch barely four years ago. The Sonic system includes more than 980 units, predominantly franchised, in 84 ADI markets across 20 southern states.

Sonic ended 1985, its first year of organizing co-ops, with a total of 17 co-op organizations. By early this year, it had grown to 50 co-ops involving 730 stores, ranging in size from a handful of units to the 70-plus-unit Dallas co-op. In 1986, Sonic spent $320,000 on major media and regional TV. In 1989, it will spend $3.5 million. Corresponding to its brief co-op history, annual sales increases have been 2% to 3% higher than before.

Although membership in a Sonic co-op is voluntary for franchisees, it is "highly advisable," says vice president of marketing Keith Sutterfield. Franchisees chip in 1.5% to 3.5% of their gross sales to the co-op, as decided by a vote. Initially, newly formed co-ops often vote a minimum contribution, but later raise the percentage "once they see how effective it is," says Sutterfield. "One of our chal-

continued on page 134

The effectiveness of pooling ad dollars is a strong argument for co-ops.

lenges is to get all of them up to 3.5%."

There are significant differences in the buying power of individual co-ops. For example, the 17-member Sonic ad co-op in the Joplin-Pittsburg (Kansas) ADI might be able to afford to buy 2,225 GRPs (gross rating points, a measure of media outreach) of media for its members. But the 50-member co-op in Kansas City, in a much more expensive media market, may be able to afford only 1,000 GRPs. Sonic's Tulsa agency prepares creative for the system, working closely with the parent company's suggestions. The company pays for the creative, while the co-ops pay for media time.

SERVICES. Effective co-ops have helped IHOP become one of the industry's leading franchisors over its 30-year history. IHOP organizes its 465-unit system, about 90% of which is franchised, into about 50 co-ops based on Arbitron ADI markets. Franchisees pay approximately 2% of gross sales to the IHOP national ad fund, to which the parent also contributes "a significant amount" of its own dollars, says director of marketing Hall. The ad fund pays for TV, radio, POS, and newspaper ads; market research; and even promotions tied to the Tournament of Roses Parade in Pasadena.

IHOP maintains a network of advertising agencies connected with its co-ops. Major creative work is done by an agency in Santa Ana, CA, that develops four-color as well as TV, radio, and POS ads for national use. Working alongside the national agency are nine regional advertising agencies that buy media in major markets such as Chicago, New York, and Philadelphia, plus a media buying service for smaller markets. The local agencies also suggest promotional tags for TV spots and create newspaper inserts and direct mail pieces, usually about one per quarter.

Quarterly meetings bring together franchisees, agency heads, and IHOP marketing executives. Often, uniting a co-op group to work toward a single goal is a challenge, admits Hall. "We can't force them to do anything. So before we spend a lot of money on a TV commercial, we make sure we've listened carefully to what they want, and to reports from our agencies and operations people in the field."

Ad co-ops are an integral part of the success of Atlanta-based Arby's, one of the industry's fastest growing franchisors, having doubled in size since 1980. Its 2,000-unit system, which is roughly 90% franchised, includes 82 advertising co-ops, which franchisees fund with contributions of 1.2% of their gross sales.

Arby's does no national advertising. Instead, it encourages co-ops to regionalize their advertising messages at the local level, whether it is the 65-store Atlanta ADI or one a fraction of the size. Arby's is responsible for the creative and point of purchase materials, while co-ops buy media time.

Arby's also has ARCOP, an optional purchasing co-op that recommends itself on the basis of cost savings. It is funded by quarterly dues, which allow the franchisees to purchase products at system rates. ARCOP is directed by a board comprised of franchise members and a parent company representative.

More than 85% of Dallas-based USA-Cafes' 600-plus franchised Bonanza steak restaurants are involved in advertising or purchasing co-ops. Of that number, 70% are in ad co-ops that pool monies for TV broadcasting, says senior vice president of marketing Will Clayborn.

For example, the Central South Enterprises co-op brings together more than 30 Nashville, TN-area Bonanza restaurants headed up by Bill Johnson, an area developer (sub-franchisor) of parent USACafes. Funded by a 3% contribution of gross sales by franchisees, the co-op spends $1 million per year in local advertising, and also conducts co-operative training and purchasing for its members.

MANDATORY MEMBERSHIP. Membership in the local media co-op is mandatory for franchisees of Columbus, OH-based Rax, which includes about 370 franchised stores in its 530-unit system. The parent company recommends a total of 4% of gross sales be expended on marketing and advertising. That breaks down into one-half of 1% earmarked for the national advertising fund, 1.5% to 2% to the local media co-op, with the balance spent on local store marketing.

In the ultra-competitive pizza segment, with its coupons, discounts, and two-for-one deals, it's no simple matter for franchise owners to compete with the marketing clout of megachains like

continued on page 139

FOODSERVICE FRANCHISING

ICE CREAM AND YOGURT STORES

	Sales ($000)			Units		
	Total	Company-Owned	Franchisee-Owned	Total	Company-Owned	Franchisee-Owned
1987	$1,610,646	$150,668	$1,459,978	9,272	320	8,952
1988*	1,879,785	171,611	1,708,174	10,838	364	10,474
1989*	2,156,605	192,204	1,964,400	12,124	394	11,731

** Estimated by respondents*

DONUT SHOPS

	Sales ($000)			Units		
	Total	Company-Owned	Franchisee-Owned	Total	Company-Owned	Franchisee-Owned
1987	$1,315,097	$293,768	$1,021,329	3,702	1,012	2,690
1988*	1,490,892	290,830	1,200,062	3,984	918	3,067
1989*	1,605,660	295,193	1,310,467	4,325	890	3,435

** Estimated by respondents*

Co-ops help to maintain a coordinated advertising voice.

5,800-unit Pizza Hut and 4,700-unit Domino's. Franchisees of Godfather's Pizza, the number-five player in pizza with about 600 stores, all but 180 of which are franchised, have organized an ad co-op in the chain's hometown market of Omaha, NE. Co-op members, which include 17 franchised units and one company store, pool 3% to 4% of their gross sales. In addition to supporting TV spots developed by Godfather's corporate staff, the advertising co-op has successfully used radio, direct mail with coupons, newspaper inserts, and promotions tied to local events such as a Beach Boys concert.

Omaha-area Godfather's franchisees have always helped each other, says Shirlene Hansen, a 13-year veteran single-store franchisee. But the mutual benefits have increased since the relationship was formalized into a co-op four years ago.

What lies ahead for franchise co-ops? "The next few years could see the creation of more purchasing and marketing co-operatives among smaller operators in order to give them greater buying and promotional clout," predicts the Washington, DC-based National Restaurant Association. Spurring on co-op formation will be the continuing trend of mergers and acquisitions among chain restaurants. Industry consolidation magnifies the cost pressures on smaller independents, as larger chains make cheaper purchasing arrangements.–**Jim Scarpa**

FOODSERVICE FRANCHISING

RESTAURANT FRANCHISING GROWTH IN SALES, 1983-1988 ($SALES: $000)

Major Activity	Total Sales			Company-owned			Franchisee-owned		
	1983	1988*	% Change	1983	1988*	% Change	1983	1988*	% Change
Chicken	$3,417,658	$5,344,553	56	$1,292,166	$2,046,256	58	$2,125,492	$3,298,297	55
Hamburgers, Franks, Roast Beef, etc.	18,947,837	30,385,756	60	5,294,782	7,402,519	40	13,653,055	22,983,238	68
Pizza	4,649,022	9,086,583	96	1,806,178	3,551,735	97	2,842,844	5,534,848	95
Mexican	1,681,668	3,317,041	97	865,461	1,776,660	105	816,207	1,540,381	89
Seafood	938,261	1,666,020	78	532,789	988,969	86	405,472	677,051	67
Pancakes, Waffles	838,291	1,435,363	71	264,442	459,956	74	573,849	975,407	70
Steak, Full Menu	7,716,262	10,724,014	39	4,095,365	5,717,587	40	3,620,897	5,006,427	38
Sandwich and Other	502,595	1,185,565	136	93,233	116,859	25	409,362	1,068,706	161
Total	38,691,594	63,144,895	63	14,244,416	22,060,540	55	24,447,178	41,084,355	68

* *Estimated by respondents*

RESTAURANT FRANCHISING GROWTH IN UNITS, 1983-1988

Major Activity	Total Units			Company-Owned			Franchisee-Owned		
	1983	1988*	% Change	1983	1988*	% Change	1983	1988*	% Change
Chicken	8,147	9,688	19	2,821	3,298	17	5,326	6,389	20
Hamburgers, Franks, Roast Beef, etc.	28,270	34,647	23	6,378	7,364	16	21,892	27,283	25
Pizza	11,852	19,761	67	4,140	6,438	56	7,712	13,323	73
Mexican	3,469	5,090	47	1,538	2,205	43	1,931	2,885	49
Seafood	2,309	2,917	26	1,197	1,681	40	1,112	1,236	11
Pancakes, Waffles	1,558	2,056	32	488	650	33	1,070	1,406	31
Steak, Full Menu	9,849	10,716	9	4,794	5,067	6	5,055	5,649	12
Sandwich and Other	2,074	4,504	117	429	339	(21)	1,645	4,165	153
Total	67,528	89,379	32	21,785	27,042	24	45,743	62,337	36

* *Estimated by respondents*

continued on page 140

SYSTEM -PROBLEMS-

The franchise situation is complex and sensitive, and easily strained.

The recent $5.75-billion takeover of the Pillsbury Co. by London-based Grand Metropolitan PLC has many Burger King franchisees breathing a collective sigh of relief. After more than three years of railing against BK's declining market share, flat sales, revolving-door management, and ineffective marketing, franchisees are welcoming their new owner with open arms.

"People view the Grand Met acquisition as a favorable event," says David J. Connor, president of the Syracuse, NY-based Carrols Corp., Burger King's largest franchisee with 156 restaurants. "The franchise community is looking at this as a new start."

As a result of the highly charged takeover battle between Pillsbury and Grand Met late last year, the widespread discontent throughout Burger King's franchisee community became a matter of public record. But Burger King and its franchisees are decidedly not alone in their less-than-harmonious association.

While a handful of foodservice companies such as McDonald's and Kentucky Fried Chicken have, on the whole, kept their franchisees contented over the years, the franchise relationship—as both parties can attest to—is a complex and sensitive one. The bond is easily strained by self-interest, mutual distrust, and a lack of communication.

MONEY CHANGES EVERYTHING. Not surprisingly, the root of the problem, many experts are quick to point out, is money. "The franchisor is looking to make his money from royalties on the franchisee's sales, and the franchisee is looking to make a profit," explains Ken Franklin, president of Franchise Development Inc., a Pittsburgh-based franchise consulting firm. "At times, these goals can conflict with one another."

Lewis Rudnick, a partner in Rudnick & Wolfe, a Chicago-based law firm specializing in franchising, agrees: "There is an inherent tension in the franchise system that often pits franchisee against franchisor. And that stems from the way in which franchisors are compensated—namely, via royalties based on sales."

In fact, many of the court cases involving the termination of a franchise agreement stem from the franchisee's underreporting of sales, and consequent underpayment of royalties, says Robert Zisk, an attorney with the Washington, DC, law firm of Schmeltzer, Aptaker, & Sheppard. Zisk, who represents franchisors in these types of litigation, says that, in his experience, while "most franchisees tend be honest businessmen making an honest living, underreporting in some chains is a fairly large problem."

On the other hand, the converse can also be true: Many franchisors have found themselves summoned to court by frustrated franchisees claiming misuse of fees. "Franchisees may feel that the franchisor is not necessarily putting the money back into the business," Franklin explains, "or applying it in the best interests of the franchise system."

THE EXTREME. In an extreme illustration of this type of situation, the franchise association of the Los Angeles-based Pioneer Take Out chicken chain filed a $25-million class action suit against the company's founder and former president, H.R. "Rick" Kaufman. Among the allegations presented in the suit was that Kaufman transferred rents, royalties, and other fees paid by the franchise system into his other company, TransPacific Industries Corp.

Overcharging franchisees for products is another aspect of the same complaint. "Through undercapitalization or just bad planning, a franchisor finds that royalties are no longer enough," says Rudnick. "So he must sell high-priced products to the franchisees, who are a captive market."

And, once again, the Pioneer suit, signed by 77 franchisees, also claims that Kaufman was charging more than fair market value for a required batter mix for the chicken—which he manufactured—as well as for an orange drink. Kaufman, for his part, turned around and countersued for $40 million. The courts have yet to rule on either suit.

OUT OF COURT. Generally, however, the courts are a last resort, a radical solution to problems raised in the franchise agreement, and the majority of those controversies do not end up in litigation, points out Philip Zeidman, a founding partner with the Washington, DC, law firm of Brownstein, Zeidman & Schomer. "You have to ask what pushed these cases from being simply a dispute into a court case," he says. "Every lawsuit has something human at its heart."

The root of many problems, experts say, is money.

Zeidman observes that, in his experience, the disputes between a franchisor and franchisee can be reduced to two basic arguments. "The franchisor claims that the franchisee has forgotten where he came from," he says. "He's forgotten that it was the franchisor who helped make him a success." The franchisee, for his part, claims that there is a lack of communication with the franchisor, Zeidman continues, "that there isn't the same sense of kinship that existed when he first signed on as a franchisee."

HEART OF THE MATTER. Communication, many agree, is indeed at the heart of the matter. In fact, it nearly always emerges in a franchisee's—and even franchisor's—complaint. Rod Jarboe, president of Pioneer Take Out's franchise association, says that one of the problems franchisees encountered with Kaufman was their inability to talk with him. "He wouldn't meet with the franchise association," Jarboe says. "And when the occasional franchisee did get in to see Kaufman, he got no satisfaction."

Laurence Kessler, president and CEO of Rochester, NY-based Kessler group, a franchisee of 17 Burger King restaurants, recalls that for a time, Burger King under J. Jeffrey Campbell was solicitous of BK franchisees. Later, however, that changed. "They paid lip service to us, but nobody really paid any attention to what we were saying," he notes.

Franchisors with an eye toward the longevity of their system work hard at keeping the lines of communication open. Fred DeLuca, founder of the Milford, CT-based Subway Sandwiches & Salads chain, stresses the importance of explaining objectives clearly and then listening to what franchisees have to say. "We're heavy on publications and communication," DeLuca says. In addition to publishing weekly newsletters, Subway has also installed a toll-free phone number that franchisees can call.

Rudnick concurs, saying, "Franchisors need to develop a mechanism that gives the franchisees access to senior management—the people who deal with the problems. If they can only talk to field management people, they can become frustrated."

But even in cases where the two parties are communicating, time and circumstances can alter the relationship. "As a franchisee grows more successful, his payments increase," Rudnick adds. "At the same time, he grows less dependent on the services of the franchisor."

Consequently, the burden on the franchisor becomes greater to hold the relationship together. "In the beginning, the franchisee is quite dependent," he continues. "Later on, once he understands the business and is making money, that changes. At that point the franchisor must work harder and find ways to maintain value."

SUPPORT SYSTEM. The best way, Rudnick suggests, is to maintain a solid support system: "good advertising, good research and development, and good products. Then the franchisee can see that key services are being performed."

When sales begin to slide, unsuccessful advertising and marketing campaigns are often the early targets of discontented franchisees. While Burger King franchisees were unimpressed with the Miami-based chain's 4.2-oz. Whopper upgrade a few years back, they were positively embarrassed by the "Herb" fiasco a year or so later.

"We were the laughing stock of the marketing community," recalls Kessler. "The Herb campaign, the 4.2-oz. Whopper—they were like the emperor's new clothes. We all said, 'What are you, nuts? This is ridiculous!' But by the time we knew about it, it was already done."

New product rollouts—sound or otherwise—that do not perform up to expec-

continued on page 146

FOODSERVICE FRANCHISING

U.S. FRANCHISED RESTAURANTS SUMMARY

Item	1987	1988*	1989*	Percent Changes 1987-88	Percent Changes 1988-89
Company-owned	25,398	27,042	28,496	6.5	5.4
Franchisee-owned	57,933	62,337	67,037	7.6	7.5
Total number of units	83,331	89,379	95,533	7.3	7.3
Company-owned	$20,026,900	$22,060,540	$24,202,074	10.2	9.7
Franchisee-owned	36,813,094	41,084,355	46,222,136	11.6	12.5
Total sales of products and services ($000)	$56,839,994	$63,144,895	$70,424,210	11.1	11.5
Merchandise (non-food) for resale	$177,092	$220,590	$238,237	24.6	8.0
Supplies (such as paper goods)	274,332	533,500	570,845	94.5	7.0
Food ingredients	1,299,326	1,467,839	1,607,284	13.0	9.5
Other	60,366	67,042	69,053	11.1	3.0
Total sales of products and services by franchisors to franchisees ($000)	$1,911,116	$2,288,971	$2,485,419	22.7	24.0

** Estimated by respondents*

TOP 50 FRANCHISE RESTAURANT SYSTEMS

1987-88 Systemwide Sales ($000,000) by Company and Franchise								
Franchise System	1988					1987	'87-'88	
	Fiscal Year	Systemwide	Avg. Unit Volume	Company-Owned	Franchisee-Owned	Systemwide	% Total Change	
1 McDonald's	12/88	$16,064	$1,596,000	$4,196	$11,868	$14,330	12.1	
2 Burger King*	5/88	5,400	1,002,000	826	4,574	5,000	8.0	
3 Kentucky Fried Chicken*	12/88	4,896	700,000	1,248	3,648	4,100	19.5	
4 Hardee's*	12/88	3,299	920,000	1,101	2,198	3,064	7.7	
5 Pizza Hut*	12/88	3,200	530,000	1,600	1,600	2,900	10.3	
6 Wendy's	1/88	2,869	741,000	918	1,951	2,747	4.4	
7 Domino's	12/88	2,307	471,276	623	1,684	1,980	16.5	
8 Dairy Queen*	11/88	2,067	403,400	2	2,065	1,878	10.1	
9 Taco Bell*	12/88	1,699	609,756	965	734	1,500	13.3	
10 Shoney's	10/88	1,447	1,371,000	762	685	1,321	9.6	
11 Denny's	12/88	1,323	1,100,000	1,115	208	1,244	6.3	
12 Arby's*	10/88	1,160	594,872	121	1,039	988	17.4	
13 Little Caesars Pizza*	12/88	1,000	476,644	243	757	725	37.9	
14 Big Boy*	12/88	960	1,000,000	81	879	950	1.1	
15 Ponderosa*	2/88	800	1,119,350	448	352	758	5.5	
16 Dunkin' Donuts	10/88	790	495,612	2	788	729	8.4	
17 Jack In The Box	10/88	775	903,000	570	205	665	16.5	
18 Long John Silver's	6/88	753	525,200	501	252	737	2.2	
19 Sizzler*	4/88	750	1,400,000	246	504	705	6.4	
20 Baskin-Robbins*	12/88	623	183,000	35	588	621	0	
21 Subway	12/88	603	208,000	3	600	360	67.5	
22 Roy Rogers*	12/88	600	1,040,000	342	258	568	5.6	
23 Bonanza Family Restaurants	12/88	571	943,000	2	569	530	7.7	
24 Popeyes Famous Fried Chicken	10/88	485	725,000	70	415	460	5.4	
25 Western Sizzlin'	10/88	463	796,000	0	463	466	0.6	
26 Church's Fried Chicken*	12/88	450	339,000	324	126	534	(15.8)	
27 Chi-Chi's	9/88	411	2,380,000	299	112	385	6.8	
28 Carl's Jr.*	1/88	399	940,000	337	62	344	16.0	
29 Rax Restaurants	7/88	366	759,000	113	253	358	2.5	
30 Captain D's	10/88	364	630,000	216	148	343	6.1	
31 Perkins Restaurants*	12/88	352	1,033,000	118	234	344	2.3	
32 Sonic*	8/88	341	353,393	26	315	306	11.4	
33 International House of Pancakes	12/88	316	689,500	29	287	297	6.4	
34 Ground Round	9/88	300	1,500,000	240	60	261	14.9	
34 Pizza Inn*	6/88	300	450,000	126	174	285	5.3	
36 Chili's	6/88	261	1,991,000	218	43	196	33.7	
37 ShowBiz Pizza*	12/88	251	1,000,000	123	128	247	1.6	
38 Round Table Pizza	7/88	250	500,000	0	250	228	9.6	
39 Godfather's Pizza*	5/88	242	414,000	75	167	261	(6.9)	
40 Ryan's Family Steak Houses*	12/88	235	2,150,000	191	44	179	31.3	
40 Waffle House*	6/88	235	380	99	136	235	0	
42 Village Inn*	10/88	230	870,000	131	99	219	5.0	
43 Marie Callender Pie Shops	12/88	225	1,500,000	115	110	203	10.8	
44 Carvel Ice Cream*	12/88	223	255,000	3	220	217	2.8	
45 Western Steer Mom 'N' Pops*	2/88	200	925,000	48	152	189	5.8	
46 Grandy's*	12/88	185	915,841	99	86	180	2.8	
47 Mr. Donut*	2/88	174	286,000	0	174	169	3.0	
48 Country Kitchen	12/88	167	660,000	2	165	161	3.7	
49 Po Folks	9/88	150	1,150,000	42	108	150	0	
50 Shakey's Pizza*	9/88	140	599,150	5	135	145	(3.6)	
50 Mr. Gatti's*	12/88	140	455,000	42	98	140	0	

* *Estimated by Restaurant Business*

Note: Data includes international operations; data is in millions of dollars, except average unit volume

TOP 50 FRANCHISE RESTAURANT SYSTEMS

1987-88 Systemwide Units by Company and Franchise

Franchise System	1988			1987			'87-'88
	Total	Company-Owned	Franchisee-Owned	Total	Company-Owned	Franchisee-Owned	% Total Change
1 McDonald's	10,513	2,600	7,913	9,911	2,399	7,512	6.1
2 Kentucky Fried Chicken	7,761	1,979	5,782	7,522	1,901	5,621	3.2
3 Pizza Hut*	6,597	2,850	3,747	6,257	2,697	3,560	5.4
4 Burger King	5,473	818	4,655	5,179	794	4,385	5.7
5 Dairy Queen	5,122	5	5,117	5,005	5	5,000	2.3
6 Domino's	4,893	1,370	3,523	4,279	1,109	3,170	14.3
7 Wendy's	3,816	1,229	2,587	3,727	1,335	2,392	2.4
8 Baskin-Robbins	3,406	192	3,214	3,398	189	3,209	0
9 Hardee's	3,110	1,038	2,072	2,912	963	1,949	6.8
10 Subway	2,898	30	2,868	1,810	10	1,800	60.1
11 Taco Bell	2,881	1,692	1,189	2,695	1,475	1,220	6.9
12 Little Caesars Pizza	2,375	578	1,797	1,820	441	1,379	30.5
13 Arby's	2,049	209	1,840	1,851	197	1,654	10.7
14 Dunkin' Donuts	1,765	6	1,759	1,669	29	1,640	5.8
15 Long John Silver's	1,469	979	490	1,420	887	533	3.5
16 Church's Fried Chicken*	1,368	990	378	1,486	1,072	414	(7.9)
17 Denny's	1,299	1,001	298	1,221	1,045	176	6.4
18 Sonic	985	74	911	955	68	887	3.1
19 Big Boy*	960	81	879	950	80	870	0
20 Jack In The Box	957	637	320	897	639	258	6.7
21 Carvel Ice Cream*	895	10	885	850	10	840	5.3
22 Ponderosa	715	400	315	677	400	277	5.6
22 Popeyes Famous Fried Chicken*	715	102	613	664	96	568	7.7
24 Pizza Inn*	666	278	388	672	282	390	(1.0)
25 Captain D's	636	272	364	604	261	343	5.3
25 Shoney's	636	272	364	604	261	343	5.3
27 Waffle House*	635	268	367	635	268	367	NC
28 Bonanza Family Restaurants	612	2	610	602	2	600	1.7
29 Sizzler*	611	200	411	548	180	368	11.5
30 Roy Rogers*	609	350	259	583	332	251	4.5
31 Mr. Donut*	599	1	598	617	1	616	(2.9)
32 Godfather's Pizza	580	180	400	605	190	415	(4.1)
32 Western Sizzlin'	580	0	580	588	0	588	(1.4)
34 Round Table Pizza	535	0	535	515	0	515	3.9
35 Rax Restaurants	521	148	373	520	156	364	0
36 International House of Pancakes	458	59	399	454	71	383	1.0
37 Carl's Jr.*	444	365	79	436	359	77	1.8
38 Perkins Restaurants	341	114	227	333	114	219	2.4
39 Mr. Gatti's*	337	101	236	337	101	236	NC
40 ShowBiz Pizza*	263	129	134	260	127	133	1.2
41 Village Inn	256	139	117	272	141	131	(5.9)
42 Country Kitchen	252	3	249	252	3	249	NC
43 Shakey's Pizza	230	9	221	250	9	241	(4.4)
44 Ground Round	215	178	37	190	158	32	13.2
45 Grandy's	205	108	97	200	108	92	2.5
46 Western Steer Mom 'N' Pops*	196	46	150	194	46	148	1.0
47 Chi-Chi's	187	122	65	183	116	67	2.2
48 Bojangles*	181	43	138	222	53	169	(7.1)
49 Marie Callender Pie Shops	150	77	73	133	72	61	12.8
50 Po Folks	147	35	112	155	40	115	(5.2)

* *Estimated by Restaurant Business*

Note: Data includes international operations

Communication between the two parties is often a problem.

tations are often a target of franchisee ire. Wendy's disappointing breakfast program still has some franchisees talking. "Wendy's is very quality-conscious, and we offered the customer a quality breakfast," says Ted Balestreri, chairman of the Monterey, CA-based Restaurants Central, a franchisee of five Wendy's restaurants. "But did you ever see a guy in a car eating an omelet?

"The company needs to do a little more work on practicality and delivery," he stresses. "We need a product we can implement at a reasonable cost."

And clearly, cost has been a factor in Wendy's rollout of the SuperBar. At an estimated cost of between $20,000 and $30,000, the SuperBar remains a large question mark for a number of Wendy's franchisees. "There's been a reluctance among some franchisees to go with an investment of that size right off the bat," Balestreri admits. "They're waiting to see how it performs in the long run."

RELUCTANCE. The reluctance among many of Wendy's franchisees to invest in the SuperBar can be viewed as a "not-unreasonable" response, says consultant Franklin. "A franchisor will add things he thinks will enhance sales," he explains. "And while a costly addition may indeed increase a store's sales, it may not necessarily bring profits up too. So, obviously, the franchisee community balks."

The other side of this coin is when the company is unable to deliver sufficient support to the franchisee. "Often a franchisee will turn to the parent company for help when problems arise," Franklin says. "He'll ask, 'How do I find employees?' or 'How do I get a leg up on the competition down the street?' And sometimes there are no easy answers. That can create a sense of tension too."

WHEN THINGS GO WRONG. And, when things begin to go wrong, it's not uncommon to hear franchisees argue that they could run the business better than the parent-company—and, in some cases, they may be correct. Last winter, Pillsbury, hoping to thwart Grand Met's takeover, threatened to spin Burger King off as an independent entity—but first, they planned to load it with debt.

Ironically, some franchisees would have been quite happy to part ways with Pillsbury. "It would have been wonderful if we could have been spun off without being too heavily encumbered," Kessler says. "We could have had our own board of directors and agenda."

But, he adds, "I wouldn't want to have been spun off at any cost."

In one instance last year, a franchisee came very close to taking the reins of his company. Carabo Inc., the privately held Bojangles franchisee based in Greenville, SC, offered to purchase the troubled chain from parent Horn & Hardart. Horn & Hardart, which had been characterized by some franchisees as being less than effective in operating the chicken and biscuits chain, had been attempting to sell it for two years.

Apparently, though, the continuing deterioration of the Bojangles system made it impossible for the two parties to arrive at an agreement, and the deal fell through—much to the dismay of remaining franchisees.

As a result, Horn & Hardart recently established H&H Restaurant Corp., a separate division that will operate the ailing Bojangles system. Newly appointed president and chief operating officer John Bifone says that his first priority is to "win back the credibility of our Bojangles franchisees."

The relationship, Bifone admits, suffers from "the classic problem: the franchisor perhaps guilty of not providing the kind of direction to franchisees that they expect."

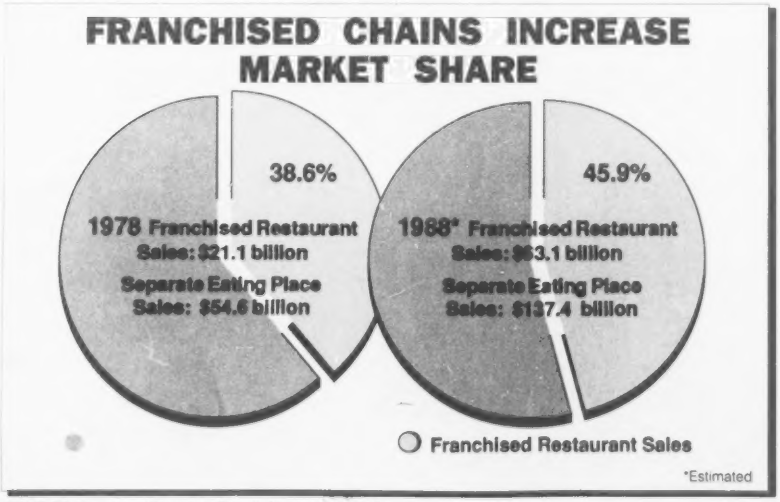
BREAKING AWAY. When a franchisee perceives that problems have become acute, he may simply decide to bail out of the system altogether. Called a "breakaway franchisee," he may decide to pull out before being affected by the trouble crippling the system. "This is a widespread phenomenon," says Rudnick. "The franchisee is convinced that he can now run the store by himself."

But while the franchisor/franchisee arrangement is certainly overrun with difficulties, the majority of those involved remain confident that the benefits outweigh the problems. "It's a kind of symbiotic relationship," observes Rudnick. "And it can be a pretty good business venture."

Kessler is completely in accord. "I'm optimistic about the future," he says.

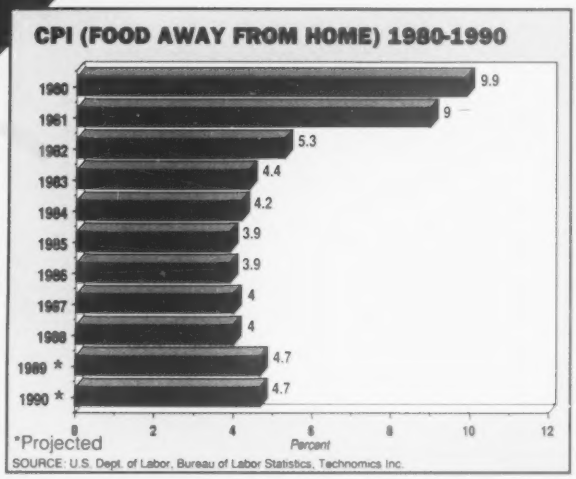
Pioneer Take Out's Jarboe points out that a large number of franchisees fled the company before its recent purchase by Intercoastal Properties. But, "the people who are left are the hardcore survivors," he says proudly. "We've been through a three-year battle with Kaufman, and spent a year in Chapter XI. We're ready to turn this thing around. We think that we are on our way to recovery."—**Paul Frumkin**

FOODSERVICE FRANCHISING



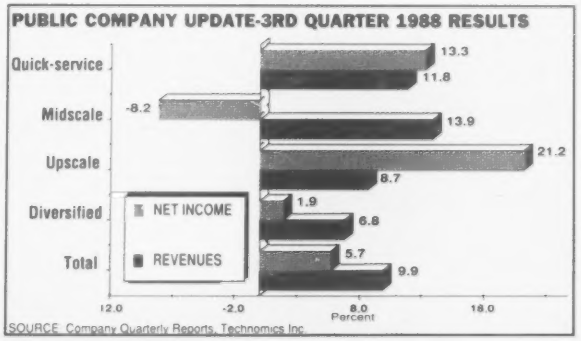
SOURCE: Restaurant Business Growth Index and U.S. Dept. of Commerce

LATELINE



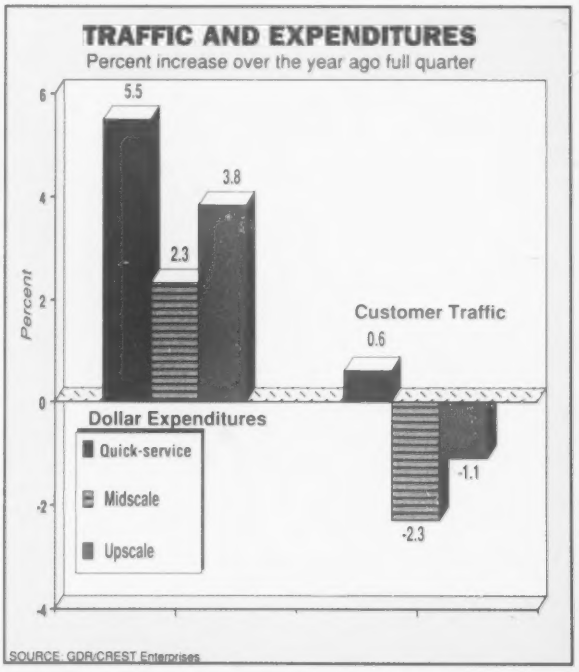
FOOD AWAY FROM HOME JUMPS

According to the U.S. Department of Labor, the Consumer Price Index (CPI) for Food Away From Home jumped a relatively modest 4% in 1988. Due in part to last summer's drought, the CPI for Food Away From Home is expected to increase 4.7% in 1989 and hold at that level through 1990. While inflation is expected to rise during the next two years, the rise should remain well below the near double-digit increases experienced in the late 1970s and early 1980s.



PUBLIC COMPANY 3RD-QTR. 1988 RESULTS

Revenues from restaurant operations increased a healthy 9.9% in nominal terms for the 90 largest publicly held restaurant chains during the third quarter of 1988 (quarters ending June to October). However, net income growth trailed revenue growth, increasing by under 6%. The quick-service segment continued to account for the majority of net income growth, led by a strong 16.8% increase by McDonald's and a 42.5% increase (to $8.7 million) in net income for Wendy's versus $0.2 million for the year-earlier period. Thanks to robust revenue growth by a number of midscale chains, including Shoney's, Morrison, and Cracker Barrel, revenues jumped nearly 14%. Unfortunately, increased revenues did not translate into net income growth, as 15 of the 33 midscale operators had decreases in net income or net losses for the period. Due almost entirely to strong performances by Chili's and TGI Friday's, net income for the upscale segment jumped 21%. Friday's had a 50% increase, to $3.8 million, while Chili's posted a 36% jump, to $3.1 million. The diversified segment (Collins Foods, PepsiCo, Pillsbury, etc.) includes results from restaurant operations only.



FALL TRAFFIC, EXPENDITURES

Quick-service restaurants outpaced the midscale and upscale segments in both customer expenditures and traffic for the fall quarter, according to figures released from CREST, a service of NPD Research, Park Ridge, IL. While growth in expenditures and traffic has improved from the summer quarter, midscale and upscale operators tracked by CREST are still showing real declines in traffic. Clearly, in 1988 (as in 1987), the quick-service segment has enjoyed literally all of the incremental growth in the industry.